

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Curt Hébert, Jr., Chairman;
William L. Massey, Linda Breathitt,
Pat Wood, III and Nora Mead Brownell.

New York Independent System Operator, Inc.

Docket No. ER01-2076-000

ORDER ACCEPTING TARIFF FILING
AS MODIFIED

(Issued June 28, 2001)

On May 17, 2001, the New York Independent System Operator, Inc. (NYISO) filed, pursuant to section 205 of the Federal Power Act,¹ a new Attachment H to its Market Administration and Control Areas Services Tariff (Services Tariff). Attachment H is a revised version of NYISO's Market Mitigation Measures (MMM) which are currently on file and have been approved by the Commission, but which are not part of a NYISO tariff. The revisions incorporate into the MMM NYISO's proposed Automated Mitigation Procedure (AMP). As discussed below, we accept NYISO's filing, as modified.

Procedural Background

In a November 23, 1999 order,² the Commission accepted in part and rejected in part the market monitoring and mitigation plans filed by NYISO. In instances where NYISO concludes that a specific market participant is exercising market power, the Commission accepted NYISO's proposals to allow it to engage in discussion to resolve the issues informally or issue demand letters requesting the participant to cease certain behavior. In addition, the Commission stated that the plans could commit NYISO to file on a case-by-case basis under section 205 of the FPA to impose specific mitigation measures, or to make such filings based on recurring types of conduct that warrant mitigation. However, the Commission rejected proposals to allow NYISO to reduce bid flexibility, impose financial obligations to pay for operating reserves, or impose default bids because this would give too much discretion to NYISO in price-setting and other similar regulatory functions without Commission review. The Commission determined that NYISO had not described with sufficient specificity the types of conduct that would trigger the imposition of these measures; it had not

¹16 U.S.C. § 824(d) (1994).

²Central Hudson Gas & Electric Corp., et al., 89 FERC ¶ 61,196 (1999).

established specific thresholds or bright line tests that would trigger the conclusion that market power had been exercised.

In a March 29, 2000 order,³ which addressed the filing NYISO made to comply with the November 23, 1999 order and requests for rehearing of that order, the Commission further clarified NYISO's authority under the plans. Among other things, the Commission accepted the specific thresholds proposed by NYISO to trigger possible mitigation, but rejected NYISO's proposal to keep them confidential. The Commission also allowed NYISO some limited discretion as to when to mitigate (e.g., NYISO may choose not to impose mitigation if it is satisfied with the party's explanation for its behavior) and for how long, but required NYISO to clarify that mitigation for market power may be imposed only prospectively.

In its March 9, 2001 notice of withdrawal of its filing in Docket No. ER01-181-000, NYISO stated that it intended to automate a step in its market mitigation measures to eliminate the current one-day delay in mitigating conduct that would otherwise set non-competitive market energy prices in the next day's Day-Ahead Market (DAM). The AMP and its background are described below. In a complaint filed in Docket No. EL01-55-000, the Mirant Companies (Mirant) stated that the March 9 withdrawal filing makes clear that NYISO improperly intended to implement the AMP without filing any changes to the MMM pursuant to either section 205 or 206 of the FPA.

In its May 9, 2001 order on Mirant's complaint (Mirant Order),⁴ the Commission found that part of NYISO's proposal is within the bounds of its existing tariff, in that section 3.2(b) of the MMM specifically envisions use of the Security Constrained Unit Commitment (SCUC) to identify questionable conduct. However, the Commission also found that NYISO's AMP proposal needed to be examined in greater detail before it could be approved. Further, the Commission noted that section 205(c) of the FPA requires that NYISO keep on file with the Commission "practices and regulations" affecting its rates, and that NYISO's tariff did not contain language adequately specifying the timing and the process that are contained in the AMP. Accordingly, the Commission concluded, that if NYISO wishes to implement its AMP proposal, it must file revised tariff sheets pursuant to section 205 of the FPA to set forth the AMP procedures. In that filing, the Commission added, NYISO must address the concerns raised by the parties in the Mirant complaint proceeding, including whether: the AMP provides sufficient opportunity for meaningful consultation, inaccurate market-clearing prices will result even if the party whose bid was improperly mitigated is ultimately made whole, the AMP would establish a new

³Central Hudson Gas & Electric Corp., et al., 90 FERC ¶ 61,317 (2000), clarified, 91 FERC ¶ 61,154 (2000).

⁴95 FERC ¶ 61,189 (2001).

\$150 threshold that never appears in the MMM, and NYISO proposes to exclude hydro units, imports, and exports from the AMP.

New York Market Mitigation Procedures

Under Commission orders allowing NYISO to implement its MMM,⁵ NYISO's Market Monitoring Unit (MMU), in consultation with NYISO's Market Advisor, is responsible for monitoring the markets administered or controlled by NYISO and for mitigating a market party's conduct when NYISO determines that market power has been exercised. The MMM currently has specific threshold values for identifying generators or transmission facilities that exercise market power. NYISO imposes mitigation when a market party's conduct has a material effect on prices or on guarantee payments. Conduct and impact criteria must be satisfied before NYISO may mitigate a generator's bid. NYISO may not mitigate market prices retroactively. Various committees within NYISO studied the development of alternative mitigation procedures through a Circuit Breaker Working Group. On February 20, 2001, NYISO's Board of Directors directed NYISO to implement the AMP.

Under its current manual procedures, NYISO is able to identify conduct and pricing impacts that exceed the MMM standards only after the SCUC runs for a given DAM have been completed, which means that mitigation cannot be implemented until the next day's DAM. Under the automated procedures of the AMP, NYISO states, non-competitive bidding behavior still will be mitigated prospectively, as authorized in the MMM, but the mitigation will occur within the SCUC runs in which the conduct and price effect thresholds of the MMM are crossed, without the one-day delay that occurs under the current manual procedures.

NYISO's AMP tests whether certain conduct results in a material change in price using NYISO's SCUC software modeling the DAM, as specified in section 3.2 of the MMM. The AMP will insert an additional step in the SCUC model to determine whether, according to the existing MMM thresholds, any energy bids that exceed the conduct thresholds would cause prices in the DAM to exceed the market impact thresholds. If the thresholds are exceeded, the AMP will immediately substitute the relevant Market Participant's Reference Prices in place of the excessive bids and then complete the remaining iterations of the SCUC on that basis. Reference Prices for the Market Participant in question will be determined and applied as specified in the MMM. The SCUC process will thus produce DAM prices that reflect mitigation of any bids that exceed the standards specified in the MMM.

NYISO's Arguments

⁵86 FERC ¶ 61,062 (1999), 89 FERC ¶ 61,196 (1999), and 90 FERC (2000).

NYISO asserts that the AMP provides appropriate opportunities for consultation between NYISO and bidders into the DAM. It maintains that under the AMP, advance consultations while bids exceeding the conduct thresholds are pending will continue to occur when NYISO observes unusually high bids. In addition, language has been proposed for section 3.3 of the MMM to make clear that if a Market Party anticipates submitting unusually high bids, it can consult with NYISO in advance about the reasons for such bids. NYISO argues that the only distinction between the AMP consultation process and the existing manual consultation process is that the Market Party, rather than NYISO, must initiate the discussion of unusually high bids to avoid being mitigated, which NYISO believes is neither significant nor onerous. Also, a Market Party may consult with NYISO on the factors that should be considered in determining the Market Party's reference levels.

With regard to the effect on market clearing prices of improperly mitigated bids, NYISO states that the small likelihood of an improperly mitigated bid must be weighed against the potential for substantial and unjustifiable wealth transfers from buyers to sellers that may occur as a result of the delays in implementing mitigation measures under the current manual procedures. NYISO claims that on June 26, 2000, buyers incurred over \$100 million in increased costs for their purchases in the DAM before mitigation measures could be imposed. NYISO also argues that unmitigated sellers and the market generally would not be harmed by the rare imposition of an unwarranted mitigation measure because, by definition, in a market clearing price auction, all such sellers would be infra-marginal, or at worst the marginal unit, and thus would be compensated at or above, perhaps well above, the price levels at which they had expressed through their bids a willingness to operate.

NYISO asserts that the proposed AMP does not establish a new threshold of \$150 for the imposition of mitigation measures because it only sets an initial pricing point at which it makes sense to perform the AMP evaluation to determine whether automated mitigation is warranted. In all cases, whether the AMP is used or not, the imposition of mitigation measures requires that the conduct and market impact thresholds specified in the MMM be crossed. NYISO has initially determined, however, that under current market conditions it is very unlikely that the thresholds for mitigation will be crossed if prices in a given area of New York are below \$150.

NYISO states that hydroelectric and external resources are not included in the AMP because of the likelihood that opportunity costs will be the primary determinant of the marginal costs of such resources. Bidding that trips the conduct thresholds by an entity that owns or controls 50 MW or less of capacity is exempt from the AMP because withholding of such small amounts will rarely have a material effect on prices. Exports are exempt from the AMP because NYISO does not have the authority under the MMM to mitigate bids in markets that it does not administer.

Finally, NYISO states that in some limited circumstances, evaluated by what NYISO refers to as a "total costs test," the mitigation of bids in the SCUC to reference levels in a limited number of hours may result in an overall increase in the average prices of energy in relevant DAM locations over the

course of the DAM as a whole. In such cases, the AMP will not be used, since to do so would be counterproductive.

NYISO requests waiver of the sixty-day notice requirement so that the tariff sheets may become effective on June 15, 2001.⁶

Notice of Filing and Pleadings

Notice of NYISO's filing was published in the Federal Register, 66 Fed. Reg. 29,100 (2001), with comments, protests, and interventions due on or before May 31, 2001. Protests and motions to intervene were filed by Aquila Energy Marketing Corporation (Aquila); Calpine Eastern; Dynegy Power Marketing, Inc. (Dynegy); HQ Energy Services (U.S.); Indeck Companies; The Independent Power Producers of New York, Inc.; Morgan Stanley Capital Group, Inc.; and NRG Power Marketing, Inc. and Affiliated Companies. The Electric Power Supply Association; KeySpan-Ravenswood, Inc.; the Member Systems;⁷ Multiple Intervenors; New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation; and Williams Energy Marketing & Trading Company filed motions to intervene and comments. Timely motions to intervene were also filed by Mirant and Sithe Power Marketing, L.P. On June 20, 2001, Dynegy and the New York State Attorney General filed additional comments concerning NYISO's proposal. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁸ the timely, unopposed motions to intervene serve to make those who filed them parties to this proceeding. Section 385.213(a)(2) of the Commission's regulations prohibits an answer to a protest unless otherwise ordered by the decisional authority. Accordingly, NYISO's June 8, 2001 answer and the June 18, 2001 reply to that answer filed by Aquila and Edison Mission Energy, Inc., et al., are rejected.

Intervenor Comments

⁶Since NYISO made the filing under the "exigent circumstances" provision of section 19.01 of the ISO Agreement, it proposes an expiration date for the AMP of September 13, 2001. However, by letter filed May 24, 2001, NYISO informed the Commission that NYISO's Management Committee has since approved the AMP filing by a 61.46 percent vote in favor. Accordingly, the proposed expiration date is no longer necessary and NYISO states that it is withdrawn.

⁷The Member Systems include Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., LIPA, Orange and Rockland Utilities, Inc., the Power Authority of the State of New York, and Niagara Mohawk Power Corporation.

⁸18 C.F.R. § 385.214 (2001).

Certain intervenors, such as the Member Systems and Multiple Intervenors, believe that current mitigation authority still allows some sellers to exercise considerable market power for a 24-hour interval. Some point to the experience of June 26, 2000, when they claim that market power was exercised, costing consumers over \$100 million. The New York State Attorney General emphasizes that the AMP is especially needed to protect consumers when electricity supplies are tight, as they are likely to be this summer. Only New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation, who support implementation of AMP, criticize the plan as needing at least two modifications to provide for correcting incorrectly mitigated prices and to allow parties to choose between participating in the DAM or RTM.

Other intervenors, such as NRG, Aquila, and the Independent Power Producers of New York, strenuously oppose the AMP, for a wide range of reasons. The most significant objections are that intervention in a reasonably competitive market is unnecessary and potentially harmful, that the AMP does not provide for adequate consultation with generators that may be subject to mitigation, that the risk of inappropriate mitigation leading to inaccurate market-clearing prices is significant, and that there is inadequate justification for excluding certain units from mitigation. Intervenors opposing the AMP emphasize that it puts the NYISO staff in the position of judging bidding strategies of various suppliers and that the AMP is simply a device to get a lower price cap. Furthermore, affidavits submitted by Aquila claim that the NYISO has mischaracterized the manner in which the AMP determines if bids have had a significant effect on the market-clearing price.

NYISO's Answer

In its answer, NYISO asserts that the AMP is necessary because even though New York markets are generally competitive, significant opportunities to abuse market power may arise occasionally due to extreme weather or facility outages. NYISO maintains that the AMP is not a price cap and that on super-peak days, prices under the AMP may well exceed the \$1000 energy bid cap previously approved by the Commission. It believes that the dire consequences predicted for shifting to generators the responsibility for initiating consultations about bids are speculative, and that the standards and procedures for determining reference prices are not appropriately addressed in this docket.

Discussion

The Commission will allow the AMP mechanism to be in place during the 2001 summer capability period. The Commission views the proposed mechanism as only a temporary solution, and agrees with certain of the intervenors that the proposed AMP may mitigate bids in situations where market power is not the cause for high or volatile bids. We also agree that the proposal may not provide for sufficient consultation with generators to reasonably establish that particular bids were

attempts to exercise market power.⁹ Accordingly, although the Commission accepts NYISO's AMP proposal for this summer, the Commission will require that the proposed mechanism terminate on October 31, 2001, the end of the 2001 summer capability period.

We do not share the NYISO's view that automatic mitigation is best done based solely on an examination of bidding behavior without determining whether there is an underlying structural market power problem. For example, when transmission constraints into New York City are binding, the presence of few independent sellers in the load pocket may confer market power on all sellers in the load pocket. In general, we believe automatic market power mitigation may be most appropriate where¹⁰ it is tied to structural market power problems such as must-run situations where generators would otherwise be in a position to name their price. We note that both PJM and ISO-NE use this more limited approach of automatic mitigation. However, because NYISO states that it is important to have an automatic mitigation procedure in place for the summer, when supplies may still be tight and when the effectiveness of new demand response mechanisms are uncertain, we will approve the AMP through October 31, 2001.

The Commission will accept without condition the other tariff sheets proposed by NYISO to the extent they simply incorporate into NYISO's Services Tariff the MMM, which have already been approved.

The Commission orders:

NYISO's proposed tariff sheets are hereby accepted to become effective as of the date of this order, and the AMP tariff provisions shall terminate on October 31, 2001, as discussed in the body of this order.

By the Commission.

(S E A L)

David P. Boergers,
Secretary.

⁹However, we also note that if NYISO subsequently determines that the bid was not an attempt to assert market power, the generator will be paid its full bid.

¹⁰Compare Part 6 of the PJM Operating Agreement and ISO-NE Market Rule 17 with NYISO's proposal, all of which reflect a different market design.